Subject: Debt Risk Management Framework

Report to: Corporate Services Committee

Report date: Wednesday, February 20, 2019

Recommendations

1. That the Debt Risk Management Framework **BE APPROVED**; and,

2. That this Report **BE CIRCULATED** to Municipal Clerks and Local Area Treasurers.

Key Facts

- The purpose of the report is to finalize the Debt Risk Management Framework which was approved at Audit Committee on May 7, 2018, however Council did not approve the framework and staff were tasked with working with Local Area Treasurers and CAOs to incorporate further feedback
- Debt Risk Management Strategy Committee was formulated, comprised of three Area Treasurers and three CAOs, and resulted in the following contributions:
    - Nine financial indicators and their formulas were agreed upon to be calculated for each area municipality
    - Definitions and context for each financial indicator are included, providing standard terminology and messaging on a summary sheet
    - Established a separate data collection form for each municipality, which includes debt approval and debt issuance forecasts, resulting in calculation of financial indicators
- Continuing efforts are being made to establish financial policies to support the Region and municipality's financial strength and mitigate overall financial risk
- This framework has been presented to the larger group of Local Area Treasurers and CAOs

Financial Considerations

There are no financial considerations for this report; however having a Debt Risk Management Framework and continuing efforts towards establishment of financial policies, will continue to support the Region's financial strategies, planning, and strong credit rating.

Analysis

The Debt Risk Management Framework aims to achieve the following:

- Provide evidence to external stakeholders of the Region's due diligence process
- Provide additional supports to Local Area Municipalities who may leverage debenture financing on a less frequent basis
- Satisfy Local Area Municipalities that collectively the Region is making best efforts to preserve each municipality's debt capacity and lowest cost of borrowing

In finalizing the framework, Niagara Region undertook the following:

- Debt Risk Management Framework was developed as the starting point towards development of financial policies – the framework was approved at Audit Committee on May 7, 2018
- Debt Risk Management Strategy Committee was assembled for the purpose of gathering feedback on the framework, and included members from Regional finance and representatives of Local Area Treasurers and CAOs:
    - Todd Harrison (Regional Treasurer)
    - Helen Chamberlain (Regional Deputy Treasurer)
    - Carmen D'Angelo (Regional CAO)
    - Bev Hendry (West Lincoln CAO)
    - Gary Long (Welland CAO)
    - Steven Gruninger (Grimsby Treasurer)
    - Kristine Douglas (St. Catharines Treasurer)
- Debt Risk Management Strategy Committee met four times during 2018, and updates and feedback was taken from the Area Treasurers and Area CAOs meetings:
    - July 9, 2018 (Debt Risk Management Strategy Committee)
    - August 3, 2018 (Debt Risk Management Strategy Committee)
    - August 17, 2019 (Area Treasurers Meeting)
    - October 29, 2018 (Debt Risk Management Strategy Committee)
    - November 16, 2018 (Area Treasurers Meeting)
    - December 3, 2018 (Debt Risk Management Strategy Committee)
    - December 7, 2018 (Area CAO Meeting)
- Debt Risk Management Strategy Committee agreed that its mandate was fulfilled, and each Local Area Treasurer agreed to provide requested information as part of the framework

The Debt risk Management Framework is summarized below:

- This information will be included as part of the debt information reports to Council ahead of capital markets debenture issuance

- The Region will request framework information from each municipality twice per year:
  1. When the Capital Budget is approved by the municipality (First Quarter)
  2. In advance of the Regional capital markets debenture issuance (Second Quarter) – may only reflect updates from those intending to issue debentures in the capital markets

The following are the components of the request for information:

1. Municipality Information (See Appendix 1)

- The first section includes two tables to be completed by each individual municipality – debt approval forecast, and debt issuance forecast
- The second section will auto-calculate the nine financial indicators, and will allow each municipality to provide comments
- Through efforts of the Debt Risk Management Strategy Committee, the following updates were made to this sheet:
  - One sheet will be provided/reported for each municipality, as opposed to consolidated
  - The sheet includes a comment section for each financial indicator

2. Debt Related Financial Indicators (See Appendix 2)

- This summary sheet defines and explains the nine financial indicators that have been chosen as a basis of measuring various types of risk
- Through efforts of the Debt Risk Management Strategy Committee, the following updates were made to this summary sheet:
  - Nine financial indicators were agreed upon, including the definition and categorization under flexibility or sustainability
  - Financial indicators removed from the original version: Debt Servicing Cost as a % of Total Operating Revenue; Debt Outstanding per 100K of Assessment, as the Committee felt this information was duplicated as part of the other nine indicators
  - Financial indicators added to the finalized version: Debt to Reserve Ratio; Total Municipal Burden as a % of Household Income. The Committee determined that these indicators assist in identifying the impact of financial policies on taxpayers

Next Steps

Staff will continue to work collaboratively with the Area Treasurers to build on the Debt Risk Management Framework, to consider financial policies, strategies and definitions, which will assist with consistent messaging around capital financing, debt and reserves. A third party facilitator may be retained to assist the Area Treasurers in establishing guiding principles and/or financial policy expertise in the following areas:

- Barriers to the use of debt

- Appropriate use of debt (i.e. life cycle replacement vs. growth)
- Rate vs. levy debt thresholds
- Impacts of rate vs. levy debt on the S&P rating methodology
- Appropriateness of self-imposed limits below the ARL
- Debt vs. other types of capital funding (i.e. pay-as-you-go, reserves, etc.)

Alternatives Reviewed

The Region could continue with the current process of reporting the Annual Repayment Limit without input from the Local Area Municipalities, however this is not recommended. Regional staff believe the new framework will allow the Region to enhance its fiduciary responsibilities, protect the Region’s credit rating, and provide greater transparency to Regional Council.

Relationship to Council Strategic Priorities

This supports organizational excellence by collaborating with municipalities on debenture issuances, ensuring confidence in the Region’s debt issuance process.

Other Pertinent Reports

AC-C 22-2018 – Debt Risk Management Framework

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Appendices

Appendix 1	Municipality Information
Appendix 2	Debt Related Financial Indicators

<u>Instructions:</u>
Step 1: Area Treasurers to complete tables in the Section A. Section B will auto-calculate.
Step 2: Area Treasurers to complete Comments in section B.
Step 3: Return completed form to Region.

Section A. Debt Requirement Data

Forecasted Debt Approval - please enter total amount of debt planned to be approved in Capital Budget

Term (Years)	Debt Approval 2018 and prior (not yet issued)	Debt Approval 2019	Debt Approval 2020	Debt Approval 2021	Debt Approval 2022	Debt Approval Beyond 2022	Total
$ 5	$ -						$ -
$ 10	$ -						$ -
$ 15							$ -
$ 20	$ -						$ -
$ 25	$ -						$ -
$ 30	$ -						$ -
Total	$ -	$ -	$ -	$ -	$ -	$ -	$ -

Forecasted Debt Issuance - please enter total amount of debt forecasted for issuance

Term (Years)	Forecasted Debt Issuance 2018		Forecasted Debt Issuance 2019		Forecasted Debt Issuance 2020		Forecasted Debt Issuance 2021		Forecasted Debt Issuance 2022 and onward		Total
	IO Amount	Capital Markets Amount	IO Amount	Capital Markets Amount	IO Amount	Capital Markets Amount	IO Amount	Capital Markets Amount	IO Amount	Capital Markets Amount	Total
$ 5	$ -	$ -									$ -
$ 10	$ -	$ -									$ -
$ 15	$ -	$ -									$ -
$ 20	$ -	$ -									$ -
$ 25	$ -	$ -									$ -
$ 30	$ -	$ -									$ -
Total	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -

Section B. Financial Indicators

Indicator	Based on Total Forecasted Debt Approval	Based on 2018 Forecasted Issuance	Comments
Annual Repayment Limit %			
Debt Service Coverage Ratio			
Debt to Reserve Ratio			
Debt Outstanding per Capita			
Net Financial Assets/(Debt) as a % of Own Purpose Taxation + User Fees			
Total Reserves & Discretionary Reserve Funds as a % of Opex			
Asset Consumption Ratio			
Operating Surplus Ratio			
Total Municipal Burden as a % of Household Income			

Debt Related Financial Indicators				
Indicator	**Definition**	**Why is it important**	**Relevant Agency/Source**	**Calculation**
Flexibility Indicators				
Annual Repayment Limit %	Percentage of tax and user fee revenues that are used to pay for principal and interest charges on debt.	This shows the % of total debt expenditures, including interest as a % of own source revenue. It is a measure of the municipality's ability to service its debt payments. A higher number indicates that debt servicing is consuming a larger portion of the operating budget and may result in constraints in funding available for other service delivery. Provincial limit is 25%, beyond which approval of the Local Planning Appeal Tribunal (LPAT) is required.	Municipal Act. This ratio is also used by BMA.	Debt Service Costs for the Year (Debt Register) / Own source revenues (SLC 81 2610 01)* *Own Source Revenues are calculated as Operating Revenues such as property taxes and user fees. Less predicable revenues such as government grants, development charges and sales of real property are excluded.
Debt Service Coverage Ratio	Revenues available after operating expenses as a percentage of annual debt servicing cost.	If this number is less than one it could indicate that the net operating income is constrained in covering debt servicing costs.	Infrastructure Ontario	Adjusted operating Surplus* / Debt Service Costs (Debt Register) *Adjusted Operating Surplus: Operating Revenues -Non-recurring Revenue -Capital Related Revenue -Total Operating Expenses +Amortization +Interest
Debt to Reserve Ratio	Total debt outstanding as a ratio of total reserves (excluding obligatory reserves such as gas tax and development charges)	Provides a measure for financial prudence. Ratio of less than one means that debt outstanding is less than reserves available. A ratio greater than one means that debt outstanding is greater than reserves available.	BMA Study	Total Debt Outstanding/Total reserves
Debt Outstanding per Capita	Debt outstanding per citizen in the municipality	A measure of how much debt a municipality has per citizen. There is no optimal number for this indicator. It is important to understand the trend and its alignment with asset management planning. Also used for benchmarking to other municipalities for comparison of their use of debt in long term financial planning.	BMA Study	Debt Outstanding/Population
Sustainability Indicators				
Net Financial Assets/(Debt) as a % of Own Purpose Taxation + User Fees	Extent to which financial liabilities could be met by operating revenues.	A ratio greater than than zero indicates that total assets exceed total liabilities. A ratio less than zero indicates that total liabilities exceed the total assets. It is important to understand the situation which is driving the trend for this metric year over year. An increasing negative number may indicate challenges for long term sustainability. A minimum three year trend is required to assess this metric.	Ministry of Municipal Affairs and Housing. BMA calculates a similar ratio on a net financial liability basis.	Net Financial Assets or Net Debt (SLC 70 9945 01) / Own Purpose Taxation + User Fees (SLC 10 0299 01 +SLC 10 1299 01) Note: Net Financial Assets = Total Assets - Total Liabilities
Total Reserves & Discretionary Reserve Funds as a % of Opex	Funds set aside for future needs/contingencies.	Reserves offer liquidity and the ability to make extraordinary operational expenditures. A high % is not necessarily better or worse. Municipalities with a high reserve % may have an opportunity to rely less on debt. Municipalities with a lower % may be relying more heavily on a pay-as-you go strategy, and may wish to think about supplementing this with a reserve strategy to ensure sustainability, because capital needs may be volatile.	Ministry of Municipal Affairs and Housing	Reserves + Discretionary Reserve Funds (SLC 60 2099 03 + SLC 60 2099 02) / Municipal Expenses (SLC 40 9910 11 – SLC 12 9910 03 – SLC 12 9910 07)

Asset Consumption Ratio	Extent to which tangible capital assets have been used.	A higher ratio may indicate significant replacement needs. However if assets are renewed and replaced in accordance with an asset management plan, a high ratio should not be a cause for concern. MMAH considers a rate of 25% or under to be relatively new, 26% to 50% to be moderately new, 51% to 75% to be moderately old and over 75% to be old.	Ministry of Municipal Affairs and Housing. This ratio is also used by BMA.	Closing Amortization Balance (SLC 51 9910 10) Cost of Capital Assets (SLC 51 9910 06)
Operating Surplus Ratio	Revenues available after operating expenses as a percentage of total revenues. An operating surplus/(deficit) arises when operating revenue exceeds (less than) operating expenses including amortization.	A positive number indicates greater financial flexiblity and sustainability. When a surplus is achieved, it indicates the ability to cover operational costs and have funds available for other purposes such as debt servicing, capital funding and reserve contributions. Long term sustainability is dependent upon ensuring that on average, over time, expenses are less than revenues. In essence, this requires current taxpayers to fully meet the cost of services. Municipalities operating with a deficit over several years should ensure that the long-range financial plan provides clear direction to turn this around. The MMA suggested target is to have an operating surplus ratio in the range of 0%-15%, with an advanced target of 15% or greater.	Ministry of Municipal Affairs and Housing. This ratio is also used by BMA.	Operating Revenue (SLC 10 9910 01) – Operating Expenses (40 9910 11) + PSAB Adjustments and other (SLC 10 2030 01 + SLC 10 2040 01 + SLC 10 2045 01) Own Source Revenues (Property Tax, User fees, service charges) (SLC 10 0299 01 + SLC 1299 01)
Total Municipal Burden as a % of Household Income	Measures total taxes (inclusive of general levy and water/wastewater) as a % of average household income	May assist in quantifying household ability to sustain taxation increases supporting infrastructure costs financed by debt.	BMA calculates total taxes as a % of household income. Region calculates total taxes as a % of weighted average household income.	Municipal: Total taxes / average household income Regional: Total taxes / weighted average Household Income